

In the Supreme Court of the United States

OCTOBER TERM, 1991

EASTMAN KODAK COMPANY, PETITIONER

v.

IMAGE TECHNICAL SERVICES INC., ET AL.

*ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT*

**BRIEF FOR THE UNITED STATES
AS AMICUS CURIAE SUPPORTING PETITIONER**

KENNETH W. STARR
Solicitor General

JAMES F. RILL
Assistant Attorney General

LAWRENCE G. WALLACE
Deputy Solicitor General

CHRISTOPHER J. WRIGHT
Assistant to the Solicitor General

CATHERINE G. O'SULLIVAN

ROBERT B. NICHOLSON

DAVID SEIDMAN

Attorneys

*Department of Justice
Washington, D.C. 20530
(202) 514-2217*

QUESTION PRESENTED

Whether the court of appeals erred in reversing a grant of summary judgment for a defendant equipment manufacturer alleged to have committed a violation of Section 2 of the Sherman Act and a per se violation of Section 1 by denying independent service organizations access to replacement parts for its equipment and by tying parts to service, when the manufacturer concededly lacked market power in the market for equipment.

TABLE OF CONTENTS

	Page
Interest of the United States	1
Statutory provisions involved	2
Statement	2
Summary of argument	8
Argument:	
Summary judgment was proper on this record because the ISOs' claims are implausible and the evidence on which the court relied is consistent with permissible competition	10
A. It is implausible that Kodak, which lacks market power in equipment markets, nonetheless has power in markets for parts of its equipment....	12
B. The ISOs presented insufficient evidence of market power in Kodak's aftermarkets to create a triable issue	16
Conclusion	26

TABLE OF AUTHORITIES

Cases:

<i>Ace-Federal Reporters, Inc. v. FERC</i> , 734 F. Supp. 20 (D.D.C. 1990)	15
<i>Anderson v. Liberty Lobby, Inc.</i> , 477 U.S. 242 (1986)	10
<i>Business Electronics Corp. v. Sharp Electronics Corp.</i> , 485 U.S. 717 (1988)	15
<i>California Architectural Building Prods., Inc. v. Franciscan Ceramics, Inc.</i> , 818 F.2d 1466 (9th Cir. 1987)	10
<i>Celotex Corp. v. Catrett</i> , 477 U.S. 317 (1986)	11
<i>Continental T.V. v. GTE Sylvania, Inc.</i> , 433 U.S. 36 (1977)	15
<i>Digidyne Corp. v. Data General Corp.</i> , 734 F.2d 1336 (9th Cir. 1984)	23
<i>General Business Systems v. North American Philips Corp.</i> , 699 F.2d 965 (9th Cir. 1983)	12, 13

Cases—Continued:

	Page
<i>Grappone, Inc. v. Subaru of New England, Inc.</i> , 858 F.2d 792 (1st Cir. 1988)	13, 22, 23
<i>International Logistics Group, Ltd. v. Chrysler Corp.</i> , 884 F.2d 904 (6th Cir. 1989), cert. denied, 494 U.S. 1066 (1990)	12
<i>Jefferson Parish Hosp. Dist. No. 2 v. Hyde</i> , 466 U.S. 2 (1984)	5, 9, 12, 20, 21, 22, 23, 24
<i>Lupia v. Stella D'Oro Biscuit Co.</i> , 586 F.2d 1163 (7th Cir. 1978), cert. denied, 440 U.S. 982 (1979)	25
<i>Matsushita Elec. Indus. Co. v. Zenith Radio Corp.</i> , 475 U.S. 574 (1986)	8, 10, 11, 20, 24
<i>Monsanto Co. v. Spray-Rite Serv. Corp.</i> , 465 U.S. 752 (1984)	10, 25
<i>National Collegiate Athletic Ass'n v. Board of Regents</i> , 468 U.S. 85 (1984)	21
<i>Northern Pac. Ry. v. United States</i> , 356 U.S. 1 (1958)	4, 24
<i>Parts & Elec. Motors, Inc. v. Sterling Elec., Inc.</i> , 866 F.2d 228 (7th Cir. 1988), cert. denied, 493 U.S. 847 (1989)	13-14
<i>Richter Concrete Corp. v. Hilltop Concrete Corp.</i> , 691 F.2d 818 (6th Cir. 1982)	12
<i>Spectrofuge Corp. v. Beckman Instruments, Inc.</i> , 575 F.2d 256 (5th Cir. 1978), cert. denied, 440 U.S. 939 (1979)	12
<i>United States Steel Corp. v. Fortner Enter.</i> , 429 U.S. 610 (1977)	22

Statutes and rule:

Sherman Act, 15 U.S.C. 1 *et seq.*:

§ 1, 15 U.S.C. 1	1, 2, 3, 4, 5, 9, 12, 17
§ 2, 15 U.S.C. 2	1, 2, 4, 7, 8, 12, 16, 17
Fed. R. Civ. P. 56	10

Miscellaneous:

II P. Adreeda and D. Turner, <i>Antitrust Law</i> , (1978)	25
Farrell & Shapiro, <i>Dynamic Competition with Switching Costs</i> , 19 Rand. J. Econ. 123 (1988)	19

Miscellaneous—Continued:

	Page
<i>Klemperer, The Competitiveness of Markets with Switching Costs</i> , 18 Rand. J. Econ. 138 (1987) ..	19
A. Oxenfeldt, <i>Industrial Pricing and Marketing Practices</i> (1951)	14, 15
M. Porter, <i>Competitive Advantage</i> (1985)	14

In the Supreme Court of the United States

OCTOBER TERM, 1991

No. 90-1029

EASTMAN KODAK COMPANY, PETITIONER

v.

IMAGE TECHNICAL SERVICES INC., ET AL.

*ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT*

**BRIEF FOR THE UNITED STATES
AS AMICUS CURIAE SUPPORTING PETITIONER**

INTEREST OF THE UNITED STATES

The United States is principally responsible for the enforcement of the Sherman Act, 15 U.S.C. 1 and 2. In this case, an equipment manufacturer lacking market power in the markets for its equipment refused to sell replacement parts to independent service organizations. The independent service organizations alleged that, by refusing to sell parts to them, the manufacturer had unlawfully tied the sale of service for its equipment to the sale of parts, in violation of Section 1, and had attempted to monopolize the sale of service for its equipment, in violation of Section 2. The resolution of this case implicates the pro-competitive policies embodied in the antitrust laws, and the United States has a strong interest in the proper interpretation of those laws.

STATUTORY PROVISIONS INVOLVED

The Sherman Act, 15 U.S.C. 1 and 2, provides:

§ 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding one million dollars if a corporation, or, if any other person, one hundred thousand dollars, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

§ 2. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding one million dollars if a corporation, or, if any other person, one hundred thousand dollars, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

STATEMENT

1. Petitioner Eastman Kodak Co. ("Kodak") manufactures and sells copiers and micrographic equipment.¹ Kodak accounts for 23% of the market for high volume photocopy machines and less than 20% of the micrographic machine market. Pet. App.

¹ Micrographic equipment is used in connection with microfilm and microfiche.

8A n.3. It also sells service and replacement parts for its machines. Respondents are independent service organizations ("ISOs"). In the early 1980s, ISOs began buying parts from Kodak and competing with it in servicing Kodak machines, sometimes offering significantly lower prices. See *id.* at 3A, 10A.

In 1985 and 1986, Kodak implemented a policy of selling replacement parts for new micrographic machines only to buyers of Kodak machines who do not purchase repair services from ISOs. That is, Kodak sells parts for micrographic machines sold after 1985 only to buyers who either repair their own machines or use Kodak service. Kodak also has a policy of not selling copier parts to ISOs; it claims never knowingly to have done so. Pet. App. 30B. The ISOs allege, however, that in the past some ISOs purchased copier parts directly from Kodak. Br. in Opp. 3 n.3.

Kodak contends that these policies are intended (i) to allow it to be responsible for the quality of service for Kodak machines, which enables it better to compete in the equipment markets by maintaining a continuing relationship with customers for its machines and protecting its reputation for quality; (ii) to reduce its parts inventories and inventory costs; and (iii) to prevent the ISOs from free-riding on Kodak's investments in the machine industries. Pet. App. 13A; Pet. 5. A direct and intended effect of the policy is to make it more difficult for ISOs to sell service for Kodak machines.

2. In 1987, a number of ISOs brought this action, alleging that Kodak had unlawfully tied the sale of service for Kodak machines to the sale of parts, in violation of Section 1 of the Sherman Act, 15 U.S.C. 1, and had unlawfully monopolized and attempted to monopolize the sale of service for Kodak machines, in

violation of Section 2 of the Sherman Act, 15 U.S.C. 2.² Pet. App. 29B.

After allowing abbreviated discovery, the district court granted summary judgment for Kodak. As to the Section 1 claim, the court found no evidence of a tying arrangement because, it said, Kodak neither required equipment buyers to purchase parts or service nor conditioned the sale of one product on the purchase of another product. Pet. App. 32B-33B. As to the Section 2 claim, the court first noted that “[p]laintiffs do not contend Kodak possesses monopoly power in the new equipment market in which it competes with Xerox, IBM, Bell and Howell, 3M and various Japanese manufacturers and holds no significant share.” *Id.* at 35B. In that circumstance, the court concluded that although Kodak had a “natural monopoly over the market for parts it sells under its name” (*ibid.*), a unilateral refusal to sell those parts to ISOs did not violate Section 2.

3. A divided panel of the Ninth Circuit reversed.

a. With respect to the Section 1 claim, the court concluded that a tying agreement existed because Kodak had conditioned the sale of its parts on the buyer’s agreement not to buy service from the ISOs. Pet. App. 5A-6A, citing *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5-6 (1958).³ If Kodak had “sufficient economic power in the tying product market [parts] to restrain competition appreciably in the tied product market [service],” the court stated,

² Additional related claims were not considered by the court of appeals.

³ The court recognized that there could be an unlawful tie between parts and service only if the two were distinct markets. It held that whether parts and service were one market or two presented a disputed issue of fact. Pet. App. 6A.

such a tying arrangement could be unlawful per se.⁴ Pet. App. 4A. But since tying is not unlawful per se in the absence of market power over the tying product, *Jefferson Parish Hosp. Dist. No. 3 v. Hyde*, 466 U.S. 2, 12-18 (1984), the court recognized that the ISOs had to prove that Kodak has power in the parts market.

It was not disputed that Kodak lacks market power in the markets for its equipment. In addition, the court recognized that potential equipment buyers “consider the cost of parts and service when initially deciding between Kodak’s equipment and its competitors’ equipment.” Pet. App. 8A.⁵ In those circumstances, the court saw merit in Kodak’s argument that it could not have market power in the market for parts for its equipment, since an attempt to charge supracompetitive parts prices would self-defeatingly cause potential equipment purchasers to purchase competitors’ equipment rather than Kodak’s equipment. *Ibid.*

The court nevertheless refused to affirm the grant of summary judgment “on this theoretical basis.” Pet. App. 10A. It thought that Kodak might be

⁴ Because the ISOs had not relied on the rule of reason in opposing summary judgment in the district court, the court of appeals limited its analysis under Section 1 to whether the tying arrangement was unlawful per se. Pet. App. 4A n.1.

⁵ In their supplemental brief filed in opposition to the petition for a writ of certiorari (at 2), the ISOs disagreed with the court of appeals’ statement that equipment buyers consider the cost of parts and service in deciding which brand of equipment to buy. But all three judges on the court of appeals thought that there was no dispute on this point. Pet. App. 8A, 20A. In any event, as we explain below, the proper resolution of this case does not turn on whether some buyers fail to consider all relevant costs.

found to have sufficient power in the parts market from evidence that (i) it charged more than the ISOs for service that was of lower quality; (ii) competition from the ISOs drove down Kodak's service prices; and (iii) some customers paid higher prices for Kodak's service rather than switch to other equipment. *Id.* at 10A-11A. Moreover, the court said that “[s]ome strength in the interbrand [equipment] market, although short of actual market power, can combine with other factors to yield power in an after-market.” *Id.* at 12A. The court stated that “market imperfections can keep economic theories * * * from mirroring reality” (*id.* at 10A), although it did not suggest what specific market imperfections or other factors might result in market power in this case.⁶ The court held that “[t]he district court improperly granted summary judgment on the Section 1 claim.” *Id.* at 15A.

Judge Wallace dissented on the ground that a lack of power in the equipment markets necessarily precluded a finding of market power in the parts markets. Pet. App. 23A. He explained that any attempt by Kodak to price service or parts supracompetitively would evidence “a self-destructive pricing strategy which lacks long-term effects upon competition.” *Ibid.* In light of the ISOs’ (and the majority’s) fail-

⁶ Because a tying arrangement that is otherwise unlawful may be saved by legitimate business reasons if no less restrictive alternative is available, the court considered Kodak’s justifications for its policy. The court concluded that the trier of fact might find the product quality and inventory reasons to be pretextual and that there was a less restrictive alternative for achieving Kodak’s quality-related goals. It held that Kodak’s desire not to permit ISOs to benefit from Kodak’s investments in the equipment markets could not, as a matter of law, justify the policy. Pet. App. 13A-14A.

ure to describe what market imperfections might exist to invalidate that conclusion (*id.* at 22A n.1), Judge Wallace concluded that the district court properly granted summary judgment on the tying claim.

b. As to the Section 2 claim, the court found sufficient evidence to support a finding that Kodak’s implementation of its parts policy was anticompetitive and exclusionary and showed a specific intent to monopolize. Pet. App. 17A. It first refused to hold “as a matter of law that service of Kodak equipment is not the relevant market in this case.” *Id.* at 19A. It then recognized the “logical appeal in Kodak’s theory that it could not have monopoly power * * * in the service market since it lacks economic power in the interbrand [equipment] markets.” *Ibid.* But the court found that the evidence of monopoly power the ISOs had presented—that some ISOs charged less than Kodak for service, that competition drove Kodak’s service prices down, and that some customers paid Kodak’s higher service charges rather than switch to other equipment (*id.* at 10A-11A)—was sufficient to withstand summary judgment. It also held that the ISOs had come forward with sufficient evidence, for purposes of summary judgment, to satisfy their burden of proving the lack of legitimate business justification. *Id.* at 18A; see also *id.* at 17A n.9.

Judge Wallace dissented with respect to the monopolization claim as well. He concluded that, entirely apart from market power considerations, Kodak was entitled to summary judgment because it had “submitted extensive and undisputed evidence of a marketing strategy based on high-quality service.” Pet. App. 25A.

SUMMARY OF ARGUMENT

In *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986), this Court held that where the factual context renders an antitrust claim "implausible—if the claim is one that simply makes no economic sense," in responding to a motion for summary judgment the plaintiff must show that the defendant's behavior is not as consistent with permissible, competitive behavior as with unlawful behavior. The court of appeals failed to follow that approach in this case.

The ISOs' claims are implausible because Kodak lacks market power in the markets for its copier and micrographic equipment. Buyers of such equipment regard an increase in the price of parts or service as an increase in the price of the equipment, and sellers recognize that the revenues from sales of parts and service are attributable to sales of the equipment. In such circumstances, it is not apparent how an equipment manufacturer such as Kodak could exercise power in the aftermarkets for parts and service.

The evidence that the ISOs have presented is inadequate to show that reality departs from theory in this case. The fact that there is evidence that some ISOs underprice Kodak does not show that Kodak has violated Section 2 of the Sherman Act by unlawfully exercising monopoly power. Rather, such evidence is fully consistent with other explanations, such as that Kodak is spreading the cost of the equipment over time. Nor does the fact that some purchasers of Kodak equipment cannot immediately switch to other equipment show that Kodak can exercise monopoly power. As Judge Wallace explained, focusing exclusively on customers who have already purchased equipment is unrealistic because man-

facturers will suffer in the competitive equipment markets if they exploit purchasers of their equipment.

Nor does the evidence presented by the ISOs show the existence of a tying arrangement that may be condemned as unlawful per se under Section 1. In *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 7, 25 (1984), this Court considered a similar case where a hospital had entered into an exclusive arrangement with anesthesiologists, and held that a tying arrangement is per se unlawful only where the seller's market power forces the buyer to purchase the tied product. The Court found no market power in that case on the basis of the hospital's 30% market share (*id.* at 26-27), which is considerably higher than Kodak's share of the equipment markets. Moreover, the Court's analysis was unaffected by customers who were locked into the hospital's services because they had already checked into the hospital. Indeed, the Court recognized that prospective patients who want to choose their own anesthesiologist will use another hospital (*id.* at 28), just as buyers of copiers and micrographic equipment who prefer to obtain service from ISOs will choose other brands of equipment.

Thus, the evidence that has been presented does not show that Kodak's behavior is inconsistent with the implementation of a permissible, competitive marketing strategy. Accordingly, the court of appeals erred by holding on the record before it that the ISOs had raised a triable issue.

ARGUMENT

SUMMARY JUDGMENT WAS PROPER ON THIS RECORD BECAUSE THE ISOs' CLAIMS ARE IMPLAUSIBLE AND THE EVIDENCE ON WHICH THE COURT RELIED IS CONSISTENT WITH PERMISSIBLE COMPETITION

Rule 56 of the Federal Rules of Civil Procedure requires the opponent of summary judgment to "set forth specific facts showing that there is a genuine issue for trial." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 256 (1986). The rule, of course, serves the interests of judicial efficiency. But in antitrust cases, where losers in the competitive marketplace may resort to protracted litigation that could deter legitimate conduct (*Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 763-764 (1984)), the rule assumes particular importance as a protector of competition. Thus, this Court held in *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986), that if the factual context renders the claim "implausible—if the claim is one that simply makes no economic sense—respondents must come forward with more persuasive evidence to support their claim than would otherwise be necessary."⁷

Under *Matsushita*, it is not enough for a party opposing summary judgment to present evidence that, although consistent with its antitrust theory, is also consistent with lawful, competitive behavior. That party must provide enough evidence to enable a rational trier of fact to reject the alternative explanation of economically sensible and lawful con-

⁷ As the Ninth Circuit has recognized, this principle applies in other areas of the law as well. See *California Architectural Building Prods., Inc. v. Franciscan Ceramics, Inc.*, 818 F.2d 1466, 1468 (1987) (fraud).

duct. Thus, in *Matsushita* the Court held that "conduct as consistent with permissible competition as with illegal conspiracy does not, standing alone, support an inference of antitrust conspiracy." 475 U.S. at 588. So too, evidence as consistent with permissible competition as with the exclusionary exercise of market power should not, standing alone, support an inference of monopolization or unlawful tying.

The court of appeals lost sight of these principles in reversing the grant of summary judgment. It should have considered, first, whether the ISOs' claims are plausible, and concluded that they are not plausible as a theoretical matter because the claims are based on the proposition that Kodak has market power in the parts market, a proposition that is inconsistent with the fact that Kodak lacks market power in the equipment market. Under *Matsushita*, the court should have considered whether the ISOs had presented evidence showing that this is an unusual case such that Kodak nevertheless has market power in the parts market and has used that power to exclude ISOs from the service market. Since the evidence does not show that this is an unusual case—but is fully consistent with Kodak's claims that it has been following a permissible marketing strategy—the court of appeals should not have concluded that the ISOs presented sufficient evidence to avoid summary judgment.⁸

⁸ Since the court of appeals found the ISOs' evidence sufficient to withstand summary judgment, it did not specifically determine (see Pet. App. 10A & n.4) whether the ISOs had been given an "adequate time for discovery" (*Celotex Corp v. Catrett*, 477 U.S. 317, 322 (1986)) prior to the award of summary judgment against them by the district court. Accordingly, this Court need not consider in the first instance respondents' complaints (Br. in Opp. 11-13) about the limita-

A. It Is Implausible That Kodak, Which Lacks Market Power In Equipment Markets, Nonetheless Has Power In Markets For Parts For Its Equipment

The essence of the ISOs' claims is that Kodak attempted to use its monopoly over *parts* for its equipment to monopolize the market for service of its equipment by tying service to parts.⁹ Thus, to establish liability under Section 1 or Section 2 of the Sherman Act in this case, the ISOs must prove that Kodak had market power in the market for parts for Kodak equipment. *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 12-18 (1984); *Richter Concrete Corp. v. Hilltop Concrete Co.*, 691 F.2d 818, 827 (6th Cir. 1982).¹⁰

In our view, the key fact in this case is that Kodak lacks market power in the markets for its equip-

tions imposed on discovery. That issue should be addressed on remand by the court of appeals in light of this Court's determination of the applicable substantive rules to be applied to respondents' Sherman Act claims.

⁹ The ISOs told the court of appeals that their claims rested on Kodak's alleged "monopoly power over the tens of thousands of copier and micrographic equipment replacement parts it makes or has made." ISO C.A. Reply Br. 16. Similarly, the ISOs told this Court that the "key issue" for both their Section 1 and their Section 2 claims is "whether Kodak enjoys sufficient economic power in the *parts* market." Br. in Opp. 21 (emphasis added).

¹⁰ We assume for the sake of argument that parts for the machines of a single manufacturer may constitute a relevant market. But see, e.g., *International Logistics Group, Ltd. v. Chrysler Corp.*, 884 F.2d 904, 908 (6th Cir. 1989), cert. denied, 494 U.S. 1066 (1990); *General Business Sys. v. North American Philips Corp.*, 699 F.2d 965, 975 (9th Cir. 1983); *Spectrofuge Corp. v. Beckman Instruments, Inc.*, 575 F.2d 256, 278-286 (5th Cir. 1978) (service), cert. denied, 440 U.S. 939 (1979).

ment.¹¹ Because it lacks power in the equipment markets, it is implausible that it could exercise market power in an aftermarket for replacement parts for Kodak equipment. From the standpoint of the buyer, both the price of the equipment and the price of parts and service over the life of the equipment are expenditures that are necessary to obtain copying and micrographic services. From the standpoint of a manufacturer that sells parts for its equipment and services its equipment, what the buyer pays for all three is revenue ultimately resulting from sales of the equipment.

In a situation such as this one, a buyer rationally regards an increase in the price of parts and service needed over the life of the equipment as an increase in the price of the equipment. Thus, the court of appeals correctly recognized that "equipment purchasers would turn to one of Kodak's competitors if Kodak tied supercompetitively priced parts or service directly to equipment." Pet. App. 9A. Similarly, as the court of appeals also recognized (*ibid.*), "equipment purchasers might turn to one of Kodak's competitors if Kodak ties supercompetitively priced service to parts." See also *Grappone, Inc. v. Subaru of New England, Inc.*, 858 F.2d 792, 796-798 (1st Cir. 1988); *General Business Sys. v. North American Philips Corp.*, 699 F.2d 965, 974-975, 977 (9th Cir. 1983); *Parts & Elec. Motors, Inc. v. Sterling Elec.*,

¹¹ Both the district court (Pet. App. 35B) and the court of appeals (*id.* at 8A) treated this key fact as undisputed, and it should therefore be taken as established for present purposes. Whether the ISOs could have shown a genuine issue of material fact as to Kodak market power in some relevant equipment market had they chosen to dispute the point rather than treat it as irrelevant is not before the Court.

Inc., 866 F.2d 228, 236 (7th Cir. 1988) (Posner, J., dissenting), cert. denied, 493 U.S. 847 (1989).

A manufacturer such as Kodak rationally regards revenues from the sale of parts and service for its equipment as ultimately attributable to sale of the equipment. Unless the equipment is sold, there will be no revenues from selling parts and service for it. Even if some prospective buyers do not fully evaluate the total cost of the equipment in choosing among equipment sellers, the manufacturer will take anticipated parts and service revenues into account in determining the equipment sales price. If equipment markets are competitive, then the greater the anticipated profits from parts and service, the lower the price a rational manufacturer will charge for equipment. In effect, manufacturers competing to sell equipment are also competing for the right to sell parts and service over the life of the equipment, and they can be expected to set prices so as to achieve a competitive return on the *package* of equipment, parts, and service.¹² To focus on prices in after-

¹² Firms selling complementary products—equipment and service, or razors and blades—often sell one product, the base product, at a low price, even at a loss, in the hope of profiting from the resulting increased sales of a complementary product. See, e.g., A. Oxenfeldt, *Industrial Pricing and Marketing Practices* 378 (1951); M. Porter, *Competitive Advantage* 436-437 (1985). If buyers in general are sensitive to the total cost of the complementary products, this pricing strategy is likely to profit the manufacturer only if buyers find it beneficial. See note 16, *infra*. If buyers do not find it beneficial, they will turn to sellers in competitive markets for the base product who use different pricing strategies. Competition in the sale of the complementary product (e.g., blades) from those who do not sell the base product (e.g., razors) may make it impossible for a manufacturer to follow this pricing strategy since, facing competition in both markets, the manufacturer

markets while ignoring pricing in the equipment market risks finding market power where there is none.

This is not just a matter of economic theory, for there are striking examples of pricing by sellers in light of profits to follow later. For instance, stenographic reporters sell transcription services under contract to administrative agencies but derive considerable revenue from selling copies to other parties. In 1989, the Federal Energy Regulatory Commission ("FERC") solicited bids for a stenographic services contract, expecting that the bidders would offer to provide the service at no charge to FERC because of the anticipated revenues from selling copies. *Ace-Federal Reporters, Inc. v. FERC*, 734 F. Supp. 20, 21 (D.D.C. 1990). Ace-Federal more than fulfilled FERC's expectations by first offering *to pay FERC* five cents per page and then offering \$1.25 million over the five-year life of the contract for the privilege of providing FERC with this service. *Id.* at 22. Clearly, when pricing an original sale, sellers take into account revenues anticipated to follow from the sale.

The reality that a manufacturer such as Kodak ordinarily cannot exercise market power in aftermarkets if it lacks market power in equipment markets comports with this Court's recognition in other contexts of the importance of interbrand competition. See *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 725 (1988), quoting *Continental T.V. v. GTE Sylvania, Inc.*, 433 U.S. 36, 52 n.19 (1977) ("so long as interbrand competition existed, that would provide a 'significant check' on any at-

would be unable to trade off profits on one product for profits on the other. See A. Oxenfeldt, *supra*, at 379.

tempt to exploit intrabrand market power"). Thus, Kodak's lack of power in the markets for its equipment renders implausible the ISOs' claim that it has power in aftermarkets for parts and service. In that circumstance, summary judgment should be granted in the absence of evidence showing that Kodak, despite its lack of power in the equipment markets, nevertheless exercises power in the aftermarkets for its equipment.

B. The ISOs Presented Insufficient Evidence Of Market Power In Kodak's Aftermarkets To Create A Triable Issue

1. The court of appeals acknowledged that it had "trouble with the monopoly power (or dangerous probability of monopoly power) issue" raised by the ISOs' Section 2 claims. Pet. App. 18A. "[T]here is logical appeal," the court said, "in Kodak's theory that it could not have monopoly power * * * in the service market since it lacks economic power in the interbrand markets." *Id.* at 19A. But the court nevertheless concluded that the evidence was sufficient to avoid summary judgment since "we cannot say that this theory mirrors reality." *Ibid.*¹³

¹³ The court suggested that "market imperfections," although not "pin-pointed" by the ISOs, could "keep economic theories about how consumers will act from mirroring reality." Pet. App. 10A. The ISOs did not point to any specific imperfection in the equipment markets or explain how such an imperfection might result in market power in aftermarkets in this case. Although we cannot demonstrate that market imperfections with such effects are impossible, we are unable to hypothesize plausible market imperfections that would result in market power in aftermarkets but not in the equipment markets. The imperfections would have to be such that Kodak could exploit the purchasers of its equipment by charg-

The court of appeals concluded that the ISOs "have presented evidence of actual events from which a reasonable trier of fact could conclude that Kodak has power in the interbrand market and that competition in the interbrand market does not, in reality, curb Kodak's power in the parts market." Pet. App. 10A.¹⁴ In particular, the court referred to "evidence that Kodak charges up to twice as much as [the ISOs] for service that is of lower quality than [the ISOs'] service[,] * * * evidence that in some instances competition from ISOs drove down the price that Kodak was willing to charge for service and that in other instances some owners of large Kodak equipment packages will pay higher prices for Kodak service rather than switch to competitors' systems." *Id.* 10A-11A.¹⁵

This evidence is insufficient by itself to create a genuine issue of material fact as to whether Kodak has, or has a dangerous probability of achieving, monopoly power in the aftermarkets, given the constraining effect of competition in the interbrand mar-

ing supracompetitive prices for parts or service while not losing potential equipment buyers or its present clients when the time came for the purchase of new equipment. See also note 17, *infra*.

¹⁴ We are unable to reconcile the court's reliance on a possible finding that Kodak has power in the interbrand markets with the court's acknowledgement that the ISOs "do not dispute Kodak's assertion that it lacks market power in the interbrand markets." Pet. App. 8A n.3. The court apparently did not rely on a distinction between "power" and "market power," because it noted that the ISOs "have not claimed that these factors are sufficient to give Kodak power in its interbrand markets." *Id.* at 12A.

¹⁵ While the court cited this evidence in the context of the ISOs' Section 1 claim, it referred to no additional evidence in connection with the Section 2 claim.

kets on Kodak's ability profitably to charge super-competitive prices in the aftermarket. As Judge Wallace explained in dissent, "[a]t best, this would be evidence that Kodak is pursuing a self-destructive pricing strategy which lacks long-term effects upon competition." Pet. App. 23A. It is not evidence of true market power, he continued, because if Kodak prices supracompetitively in the aftermarket, "competitive forces will exact a heavy toll in the inter-brand market, and profits gained from the short-term parts mark-ups will quickly be eclipsed." *Ibid.* Indeed, evidence that ISOs would underprice Kodak in the service market if they had access to Kodak's parts may merely reflect a Kodak marketing strategy of spreading over time the total cost to the buyer of Kodak equipment. See note 12, *supra*.¹⁶

The majority focused on customers who have already purchased Kodak equipment, and who may be "locked in" to Kodak parts until they are ready to replace that equipment. But as Judge Wallace observed, this ignores the important relationship between Kodak's conduct in the aftermarket and its vital future sales of equipment—sales on which its future parts and service sales depend. Manufacturers competing in equipment markets must take into account the effect of their treatment of previous buyers on future sales of equipment both to those buyers as potential repeat customers and to other potential

¹⁶ A pricing strategy based on lower equipment prices and higher aftermarket prices may benefit buyers in several ways. If the equipment is expensive, the strategy makes it easier for the buyer to finance the initial purchase. Moreover, it may ease the plight of the buyer of equipment that turns out to be unsatisfactory. Nevertheless, a buyer who has benefited from a low equipment price can be expected, after that purchase, to prefer to pay low aftermarket prices as well.

customers.¹⁷ Purchasers, in turn, have an obvious economic incentive to foresee, and protect themselves from, exploitation by the manufacturer. Indeed, the court found it undisputed "that equipment purchasers consider the cost of parts and service when initially deciding between Kodak's equipment and its competitors' equipment." Pet. App. 8A.¹⁸

Evidence that an equipment manufacturer provided more expensive service than ISOs would not

¹⁷ Economists have constructed models in which firms have an incentive to exploit their locked in customers. See, e.g., Farrell & Shapiro, *Dynamic Competition with Switching Costs*, 19 RAND J. Econ. 123 (1988); Klemperer, *The Competitiveness of Markets with Switching Costs*, 18 RAND J. Econ. 138 (1987). But those models assume the firms have market power with respect to sales of the original product; they also assume two discrete time periods, after which no further sales occur. If Kodak had market power in equipment markets, or if it left the equipment markets while continuing to sell parts and service, those models might be relevant here, but the case would be very different from the one actually before the Court.

¹⁸ Relying on a law review article, the ISOs suggest that purchasers might have difficulty discovering restrictions in the aftermarket or in estimating perfectly the cost of parts and service over the life of the equipment. Br. in Opp. 14-15. The record in this case, however, gives no reason to think that equipment buyers were taken by surprise here: Kodak faced "little competition" from ISOs until the early 1980s (*id.* at 2), there is no evidence that Kodak changed its long-standing policy with respect to copier parts, Kodak continues to sell parts for pre-1985 micrographic equipment to ISOs, and for new micrographic equipment Kodak's policies are spelled out in its sales contracts (*id.* at 3). In any event, as we explain above, even if buyers do not accurately forecast parts and service prices, manufacturers facing competitive equipment markets have an incentive to price their equipment taking into account the likely sales of parts and service to be generated by sales of the equipment.

establish manufacturer market power over replacement parts for its own equipment when it lacks market power in the equipment market itself. Even evidence that Kodak charged more for poorer quality service would be consistent with a marketing strategy of spreading the cost of equipment more evenly over its life by charging a lower initial purchase price and higher service fees. Whatever Kodak's particular strategy, the fact remains that it cannot set service or parts prices without regard to the impact on the market for equipment, in which it lacks market power.¹⁹

In sum, the evidence the ISOs presented is "as consistent with permissible competition" (*Matsushita*, 475 U.S. at 588) as with the unlawful exercise of market power. Hence, that evidence is plainly insufficient to overcome the inherent implausibility in the ISOs' monopolization claim, and the court of appeals accordingly erred by holding the evidence adequate to avoid summary judgment on the Section 2 claim.

2. The result should be no different if the ISOs' claims are analyzed as a tying arrangement under Section 1 of the Sherman Act. Relying on this Court's decision in *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984), the court of appeals held that Kodak could be found to have unlawfully tied service to parts, under the *per se* rule, if it "is able to force or to induce some potential tying-product customers (here potential Kodak parts customers) to purchase the tied product (here Kodak service) that

¹⁹ This is so even if all, rather than just "many," Kodak parts "are unique and available only from Kodak" (Pet. App. 11A), since the implausibility of the exercise of power in the parts market depends on competition in the interbrand equipment markets, not on multiple sources of replacement parts.

these customers would not purchase absent the tying arrangement." Pet. App. 7A. The court then overturned the grant of summary judgment based on evidence that some customers were induced to purchase Kodak service because they were "locked in" to Kodak equipment by the cost of switching to a different brand of equipment. *Id.* at 7A-8A, 10A-11A.²⁰

The court of appeals seriously misread this Court's opinion in *Hyde*. In that case, the Court held that East Jefferson Hospital's policy of requiring surgical patients to use the services of anesthesiologists with whom the hospital had an exclusive contractual arrangement was not a *per se* unlawful tie. In reaching that conclusion, the Court proceeded from a well-established premise: "not every refusal to sell two products separately can be said to restrain competition." 466 U.S. at 11. Indeed, the Court noted that "[b]uyers often find package sales attractive; a seller's decision to offer such packages can be merely an attempt to compete effectively—conduct that is entirely consistent with the Sherman Act." *Id.* at 12. For this reason, "tying may have procompetitive justifications that make it inappropriate to condemn without considerable market analysis." *National Collegiate Athletic Ass'n v. Board of Regents*, 468 U.S. 85, 104 n.26 (1984). *Per se* condemnation of a tie-

²⁰ That many Kodak parts may be "unique and available only from Kodak," Pet. App. 7A, adds nothing to the "lock in" analysis. Customers need Kodak parts only because they need to repair Kodak equipment. If switching from Kodak equipment to other equipment were costless, the availability of Kodak parts would matter not at all. Thus, the cost of switching alone, not the limited availability of parts, induced some Kodak customers to purchase service from Kodak rather than from ISOs.

in is appropriate only where "anticompetitive forcing is likely." *Hyde*, 466 U.S. at 16.²¹

In *Hyde*, this Court held that anticompetitive forcing is not likely unless a "seller has some special ability—usually called 'market power'—to force a purchaser to do something that he would not do in a competitive market." *Hyde*, 466 U.S. at 13-14. Anticompetitive "forcing" does not exist simply because some purchasers of a tied sale would prefer to purchase the tying product separately. *Id.* at 25. Rather, only if consumers are "forced * * * as a result of the [seller's] market power would the arrangement have anticompetitive consequences." *Ibid.* (emphasis added). In this case, the court of appeals effectively read the market power requirement out of *Hyde*.

The First Circuit, in contrast, has recognized that "the 'market power' hurdle" to *per se* liability for tying is at least high enough that "it cannot ordinarily be surmounted simply by pointing to the fact of the tie itself or to a handful of objecting custom-

²¹ *Hyde* makes clear that tying arrangements are but an alternative use of market power that could otherwise be used to "enhanc[e] the price of the tying product." *Id.* at 14. While the Court some years earlier said that *per se* unlawful tying does not depend on "monopoly power" (*United States Steel Corp. v. Fortner Enter.*, 429 U.S. 610, 620 (1977)), even then it made clear that market power over price is required. *Id.* at 620 n.13. *Per se* unlawful tying, then, appears to require substantial market power, power akin to monopoly power and quite close to monopoly power in degree. See *Grappone*, 858 F.2d at 796-797 (the power to raise prices only with respect to buyers with unusual or special needs for a seller's product is insufficient to pass the *Hyde* market power screen; virtually every seller of a branded product has that much market power, and to condemn ties based on that power alone would condemn harmless, and even useful, ties).

ers." *Grappone, Inc.*, 858 F.2d at 796 (per Breyer, J.). Furthermore, in *Hyde* the Hospital's 30% market share did not demonstrate a "dominant market position" and provided an insufficient basis for inferring the requisite market power. 466 U.S. at 27. Kodak's market share is well under 30%. The court of appeals thus erred in holding that sufficient market power for a *per se* tying violation could be shown merely by an effect on "some potential tying-product customers." Pet App. 7A.

Moreover, in *Hyde* the Court assessed market power with reference to the time patients selected East Jefferson Hospital, not the subsequent time when, having chosen East Jefferson, they were being wheeled into the operating room. 466 U.S. at 26-28. The court of appeals therefore compounded its error by relying solely on "locked in" customers who had already purchased Kodak's equipment. A focus on those who have already purchased Kodak equipment, contrary to *Hyde*, ignores the real constraint on the manufacturer's exercise of market power in parts markets that results from competition in the equipment markets.²²

Under the court of appeals' decision in this case, an equipment manufacturer's efforts to compete against other equipment manufacturers by devising an equipment/parts/service package that it hopes

²² In *Digidyne Corp. v. Data General Corp.*, 734 F.2d 1336 (1984), cert. denied, 473 U.S. 908 (1985), the Ninth Circuit found that a "lock in" effect enhanced the defendant's market power, a less extreme position than the court of appeals took in this case. Nevertheless, Justices White and Blackmun, dissenting from the denial of certiorari, questioned "whether market power over 'locked in' customers must be analyzed at the outset of the original decision to purchase." 473 U.S. at 909.

will appeal to buyers may be found unlawful by a jury. But under this Court's decision in *Hyde*, where a manufacturer lacks effective market power in the equipment markets, the tie of parts to service should not be held to so plainly "lack * * * any redeeming virtue" that it is "conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm [it has] caused or the business excuse for [its] use." *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5 (1958).²³

As is the case with respect to their monopolization claim, the ISOs have failed to present sufficient evidence to show that their tying claim is plausible. To the contrary, this Court's decision in *Hyde* shows that the evidence the ISOs have presented is entirely inadequate to mount the hurdle presented by Kodak's admitted lack of market power in the equipment markets. On the record before the court of appeals, Kodak's decision to tie service of its equipment to the sale of parts is entirely consistent with the conclusion that Kodak has implemented a permissible marketing strategy. Accordingly, under *Matsushita* the court of appeals should not have reversed the grant of summary judgment on the Section 1 claim.

* * * * *

As *Matsushita* recognized, "antitrust law limits the range of permissible inferences from ambiguous evidence." 475 U.S. at 588. And, as that decision further recognizes, summary judgment plays a critical role in preventing unsoundly based antitrust claims

from converting the antitrust laws into a weapon against permissible competitive behavior. "Not only do antitrust trials often encompass a great deal of expensive and time consuming discovery and trial work, but also * * * the statutory private antitrust remedy of treble damages affords a special temptation for the institution of vexatious litigation." *Lupia v. Stella D'Oro Biscuit Co.*, 586 F.2d 1163, 1167 (7th Cir. 1978), cert. denied, 440 U.S. 982 (1979); see also II P. Areeda and D. Turner, *Antitrust Law* 57-58 (1978). It is a hard, litigation-provoking fact that procompetitive and anticompetitive behavior may have similar objectives and similar consequences for competing firms; indeed, those legally polar extremes in market behavior may actually appear "indistinguishable" when "judged from a distance." *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. at 762. Hence, too easy resort to the antitrust laws by "losers" in the marketplace carries with it the daunting prospect of protracted litigation that may well deter procompetitive conduct. *Id.* at 763-764. That is precisely the danger that requires rejection of the unsound "theory" of antitrust liability urged here by the respondents and adopted by the court of appeals.

²³ Proper resolution of the market power issues in this case makes resolution of the business justification issues unnecessary. Pet. App. 18A, 25A. If Kodak lacks the requisite market power over parts (see note 21, *supra*), it does not need to present a business justification for its conduct to obtain summary judgment.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

KENNETH W. STARR
Solicitor General

JAMES F. RILL
Assistant Attorney General

LAWRENCE G. WALLACE
Deputy Solicitor General

CHRISTOPHER J. WRIGHT
Assistant to the Solicitor General

CATHERINE G. O'SULLIVAN

ROBERT B. NICHOLSON

DAVID SEIDMAN
Attorneys

AUGUST 1991